

## Message Text

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ACTION EUR-12

INFO OCT-01 EA-07 IO-13 ISO-00 SP-02 USIA-06 AID-05 EB-07

NSC-05 CIEP-01 TRSE-00 SS-15 STR-04 OMB-01 CEA-01

CIAE-00 COME-00 FRB-03 INR-07 NSAE-00 XMB-02 OPIC-03

LAB-04 SIL-01 L-03 H-02 PA-01 PRS-01 /107 W

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R 111514Z NOV 76

FM AMEMBASSY BONN

TO SECSTATE WASHDC 3206

INFO AMEMBASSY LONDON

AMEMBASSY PARIS

AMEMBASSY ROME

AMEMBASSY TOKYO

USMISSION EC BRUSSELS

USMISSION OECD PARIS

USMISSION USBERLIN

USMISSION NATO BRUSSELS

USDEL MTN GENEVA

USNMR SHAPE

AMCONSUL FRANKFURT

AMCONSUL MUNICH

AMCONSUL BREMEN

AMCONSUL DUSSELDORF

AMCONSUL STUTTGART

CINC USAFE RAMSTEIN

CINC USAREUR HEIDELBERG

CINC EUR VAIHINGEN

C O N F I D E N T I A L SECTION 01 OF 03 BONN 19126

DEPARTMENT PASS TREASURY, FRB AND CEA

E.O. LL652: GDS

TAGS: EFIN, ECON, GW

SUBJECT: APEL TAKES TOUGH LINE ON 1977 BUDGET

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1. SUMMARY -- FEDERAL MINISTER OF FINANCE APEL OPENED

THE FINAL ROUND OF INTERMINISTERIAL NEGOTIATIONS ON THE 1977 FEDERAL BUDGET WITH AN ANNOUNCEMENT ON NOV. 7 THAT THE BUDGET WILL BE LIMITED TO DM 173 BILLION OR AN INCREASE OF 5.5 PERCENT OVER 1976. THIS WOULD BE A VERY TOUGH BUDGET INDEED SINCE APEL'S PERCENTAGE CALCULATION OMITTS THE BASE RAISING EFFECT OF THIS YEAR'S ECONOMIC STIMULATION OUTLAYS. INCLUDING THESE MEANS THAT HIS PROPOSED 1977 BUDGET WOULD HAVE ONLY 2 PERCENT NOMINAL GROWTH, AND A NEGATIVE 3.5 TO 4.5 PERCENT REAL GROWTH IF THE ANTICIPATED RATE OF INFLATION (PUBLIC CONSUMPTION DEFLATOR) IS TAKEN INTO ACCOUNT. THE RECONCILING PROCESS OF SORTING OUT THE COMPETING DEMANDS ON THE DIMINISHING REAL PIE BY THE MINISTRIES IS UNDERWAY. IN THE END SOME INCREASE IN THE OVERALL PROPOSED BUDGET AMOUNT MIGHT WELL OCCUR AND IN ADDITION THE 1977 BUDGET MAY BE SUPPLEMENTED BY ADDITIONAL ECONOMIC-STIMULATIVE MEASURES IF THE RECOVERY CONTINUES TO LAG. BUT REAL GAINS IN THE BUDGETS OF ANY MINISTRY SEEM NOT VERY LIKELY AT THIS TIME. THE FINAL CABINET DECISION ON THE BUDGET WILL BE FORTHCOMING IN 5-6 WEEKS.

EXPERTS FROM THE BERLIN (DWI), IFO AND KIEL ECONOMIC RESEARCH INSTITUTES WITH WHOM WE HAVE SPOKEN HAVE ALL DESCRIBED THE BUDGET AS "RESTRICTIVE" AND LIKELY TO REMAIN SO EVEN AFTER ALL THE BARGAINING IS OVER. THEY DO NOT FEEL SUCH A POLICY IS WISE IN VIEW OF THE ECONOMIC OUTLOOK. END SUMMARY.

2. FINANCE MINISTER APEL ANNOUNCED NOV. 7 THAT IN HIS VIEW THE 1977 BUDGETED EXPENDITURES OF THE FEDERAL GOVERNMENT SHOULD BE LIMITED TO A 5.5 PERCENT INCREASE OVER THE 1976 LEVEL. THE SPECIFIC AMOUNT CITED FOR NEXT YEAR'S TOTAL FEDERAL EXPENDITURES WAS DM 173 BILLION. THE RATE OF INCREASE MENTIONED IS DECEPTIVE SINCE, AS OUR FINANCE MINISTER CONTACTS TELL US, ACTUAL TOTAL 1976 EXPENDITURES WILL BE NEAR DM 170 BILLION AFTER THE ECONOMIC STIMULATION (KONJUNKTUR) PROGRAM OUTLAYS ARE TAKEN INTO ACCOUNT. THE 5.5 PERCENT FIGURE USED BY APEL IS BASED ON A CONFIDENTIAL

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1976 EXPENDITURE FIGURE OF DM 164 BILLION, WHICH ARE THE PROJECTED FEDERAL EXPENDITURES LESS THE KONJUNKTUR PROGRAM OUTLAYS. THEREFORE, TAKING ALL THINGS INTO ACCOUNT, THE NOMINAL INCREASE IN GOVERNMENTAL EXPENDITURES UNDER APEL'S LIMITATIONS WOULD BE MORE LIKE 2 PERCENT IN 1977. THIS PICTURE COULD BE ALTERED, OF COURSE, IF NEW STIMULATIVE PROGRAMS ARE ADDED LATER ON. TO DATE, THOUGH, THERE

HAS BEEN NO PUBLIC MENTION OF THIS POSSIBILITY AS  
THE OFFICIAL POLICY EMPHASIS HAS BEEN ON INFLATION  
CONTROL, TAX INCREASES, AND SPENDING AUTHORITY.

3. THE JOINT FORECAST OF THE ECONOMIC RESEARCH  
INSTITUTES PROJECTS A PUBLIC CONSUMPTION DEFLATOR  
OF 6.5 PERCENT FOR 1977. OUR FINANCE MINISTRY

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ACTION EUR-12

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LAB-04 SIL-01 L-03 H-02 PA-01 PRS-01 /107 W

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R 111514Z NOV 76

FM AMEMBASSY BONN

TO SECSTATE WASHDC 3207

INFO AMEMBASSY LONDON

AMEMBASSY PARIS

AMEMBASSY ROME

AMEMBASSY TOKYO

USMISSION EC BRUSSELS

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C O N F I D E N T I A L SECTION 02 OF 03 BONN 19126

CONTACT TOLD US THAT HE THOUGHT THAT THE PUBLIC CONSUMPTION DEFLATOR MIGHT MORE LIKELY BE IN THE 5.5 TO 6.0 PERCENT RANGE. THE NET RESULT, IF APEL'S OVERALL BUDGET LIMIT SHOULD STAND, WOULD BE THAT THERE COULD  
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BE A SHRINKAGE IN REAL TERMS OF BETWEEN 3.5 AND 4.5 PERCENT IN ACTUAL FEDERAL OUTLAYS IN 1977 AS COMPARED TO 1976 (2.0 - 6.5 -4.5). THIS COULD HAVE A CONSIDERABLE DEFLATIONARY EFFECT ON THE ECONOMY IN A YEAR OF PROJECTED MODERATE GROWTH (PARTICULARLY DOMESTIC) LACED WITH UNCERTAINTIES, ESPECIALLY WITH RESPECT TO THE ALL-IMPORTANT FOREIGN DEMAND SIDE.

4. THE BUDGETARY SITUATION ALSO MEANS THAT ALL THE FEDERAL MINISTRIES WILL BE SCRAMBLING FOR THEIR SHARE OF A DIMINISHED REAL PIE. THAT ANY OF THEM WOULD BE ABLE TO EKE OUT A REAL INCREASE IN THEIR BUDGETS WOULD BE A MINOR MIRACLE.

5. ON THE TAX REVENUE SIDE, THE PICTURE NOW IS ALTERED DOWNWARD FROM PREVIOUS PROJECTIONS. JUST A COUPLE OF MONTHS AGO THE FEDERAL GOVERNMENT ESTIMATED THAT ITS TAX REVENUES IN 1977 WOULD BE DM 143.7 BILLION. THIS ESTIMATE WAS BASED ON THE ASSUMPTION THAT NOMINAL 1977 GNP GROWTH WOULD BE 10 PERCENT (AND IN 1976 TOO). NOW, OUR CONTACTS TELL US, THE MINISTERIAL WORKING GROUP IN DECEMBER WILL PROBABLY LOWER THIS GROWTH ESTIMATE TO 9.5 PERCENT (FOR 1976 AS WELL) AND THEREBY LOWER EXPECTED TAX REVENUES BY ABOUT DM 700 MILLION IN 1977. THE REDUCED TAX REVENUE ESTIMATE WOULD THEN BE ABOUT DM 143 BILLION. NON-TAX REVENUES SHOULD AMOUNT TO ABOUT DM 4 BILLION. TAKING INTO ACCOUNT DM 173 BILLION EXPENDITURES THIS COULD LEAVE A PROJECTED DEFICIT TO BE FINANCED OF ABOUT DM 26 BILLION. ANOTHER DM 3 BILLION IN ADDITIONAL REVENUE COULD COME FROM AN INCREASE OF 2 PERCENTAGE POINTS IN THE VALUE ADDED TAX TO BECOME EFFECTIVE JULY 1, 1977. THIS LATTER DEVELOPMENT, OF COURSE, IS STILL FAR FROM CERTAIN SINCE IT REQUIRES THE APPROVAL OF THE OPPOSITION-CONTROLLED BUNDESRAT WHICH HAS SO FAR BEEN NEGATIVE ON THE PROPOSAL. IF THE VAT INCREASE WERE MADE EFFECTIVE, THIS WOULD REDUCE THE DEFICIT TO DM 23 BILLION. THIS IS PRECISELY THE AMOUNT OF DEFICIT FINANCING PERMITTED

IF THE CURRENT EXCEPTION TO THE DEBT LIMITATIONS  
OF ARTICLE 115 OF THE BASIC LAW SHOULD NO LONGER  
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APPLY IN 1977 AS APEL IS MAINTAINING IN HIS CURRENT  
BUDGET BARGAINING WITHIN THE CABINET.

6. COMMENT -- UNDOUBTEDLY APEL'S RESTRICTIONIST  
STATEMENTS HAVE A TACTICAL ELEMENT IN THEM CALCULATED  
TO BE USEFUL TO HIM AS KEEPER OF THE PURSE.  
THE BATTLE OF THE BUDGET IS NOW BEING JOINED AND WILL  
NOT BE FULLY RESOLVED UNTIL FIVE OR SIX WEEKS FROM  
NOW WHEN THE FINAL CABINET DECISION IS MADE. EVEN  
THE TENTATIVE MINISTERIAL ALLOCATIONS ARE AS YET  
A WELL KEPT SECRET. APEL ADMITS THAT THE TOTAL  
DEMANDS OF THE VARIOUS MINISTRIES EXCEED HIS DM 173  
BILLION EXPENDITURE FIGURE BY SOME DM 10 BILLION.  
THE VARIOUS COMPETING DEMANDS ON THE FEDERAL BUDGET  
UNDOUBTEDLY ARE LEADING TO MUCH BARGAINING. IN THIS  
PROCESS, THOUGH, APEL CARRIES, AFTER THE CHANCELLOR,

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R 111514Z NOV 76  
FM AMEMBASSY BONN  
TO SECSTATE WASHDC 3208  
INFO AMEMBASSY LONDON

AMEMBASSY PARIS  
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USDEL MTN GENEVA  
USNMR SHAPE  
AMCONSUL FRANKFURT  
AMCONSUL MUNICH  
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AMCONSUL STUTTGART  
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C O N F I D E N T I A L SECTION 03 OF 03 BONN 19126

THE HEAVIEST WEIGHT DUE TO THE BUDGET-MAKING ROLE OF  
THE FINANCE MINISTRY. PART OF THE TACTICS INVOLVED  
ARE ALSO WITH RESPECT TO THE PROPOSED VAT INCREASE  
AND RELATED REVENUE SHARING ARRANGEMENTS WITH THE  
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STATES, WHICH ARE ALSO FEELING THE FISCAL PINCH AND  
NEED ADDITIONAL TAX REVENUES. PART OF THE BARGAINING  
PROCESS IS ARTICLE 115 OF THE GERMAN BASIC LAW WHICH  
IN "NORMAL" TIMES LIMITS FEDERAL BORROWING TO  
THE AMOUNT OF INVESTMENT EXPENDITURES IN THE BUDGET  
CONCERNED. THIS ARTICLE HAS AN ESCAPE CLAUSE, HOWEVER,  
THAT LIFTS THE LIMITATION IN TIMES OF ECONOMIC  
DISEQUILBRIA. THE ESCAPE CLAUSE HAS BEEN  
UTILIZED IN BOTH 1975 AND 1976 AND WITH UNEMPLOYMENT  
WHAT IT IS LIKELY TO BE IN 1977, IT MIGHT BE USED  
AGAIN. THE OPPOSITION COULD BE FORCED TO GO ALONG WITH-  
OUT TOO MUCH OBJECTION IF THE STATES THEY CONTROL  
WOULD OTHERWISE FINANCIALLY SUFFER AND IF THEY STICK  
TO THEIR REJECTION OF A VALUE-ADDED TAX INCREASE. WE  
SEE, THEREFORE, THE POSSIBILITY THAT THE BUDGET THAT  
APEL HAS DELINEATED HAS POTENTIAL FOR EXPANSION DES-  
PITE ASSERTIONS TO  
THE CONTRARY. IT BECOMES NOW A MATTER OF POLITICS  
AS MUCH AS ECONOMICS AS THE PROCESS GOES ON.  
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